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IN THE

Supreme Court of the United States

OCTOBER TERM, 1974

Nos. 74-165, 74-166, 74-167 and 74-168

ROBERT W. BLANCHETTE, RICHARD C. BOND AND JOHN H. McARTHUR, AS TRUSTEES OF THE PROPERTY OF PENN CENTRAL TRANSPORTATION COMPANY, DEBTOR, *Appellants,*

v.

CONNECTICUT GENERAL INSURANCE CORPORATION, *ET AL., Appellees.*

RICHARD JOYCE SMITH, AS TRUSTEE OF THE PROPERTY OF THE NEW YORK, NEW HAVEN AND HARTFORD RAILWAY COMPANY, DEBTOR, *Appellant,*

v.

UNITED STATES OF AMERICA, *ET AL., Appellees.*

UNITED STATES RAILWAY ASSOCIATION, *Appellant,*

v.

CONNECTICUT GENERAL INSURANCE CORPORATION, *ET AL., Appellees.*

UNITED STATES OF AMERICA, *ET AL., Appellants,*

v.

CONNECTICUT GENERAL INSURANCE CORPORATION, *ET AL., Appellees.*

On Appeal from the United States District Court for the Eastern District of Pennsylvania

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REPLY BRIEF FOR APPELLANTS ROBERT W. BLANCHETTE, RICHARD C. BOND and JOHN H. McARTHUR, TRUSTEES OF THE PROPERTY OF PENN CENTRAL TRANSPORTATION COMPANY, DEBTOR

The Penn Central Trustees believe that this Court should conclude that the Regional Rail Reorganization Act of 1973 (the "Act") is, with one minor exception, a valid exercise of the powers of Congress. However, the Trustees are not in full agreement with the Government appellants — the

United States and the United States Railway Association ("USRA") — on several of the issues raised by these appeals; thus a reply to the Government briefs, as well as to the briefs of the creditor appellees, is necessary.

The Trustees also wish to underscore the urgent need for a resolution of the issues before this Court. Because of the legal uncertainties attending the Act, the public interest in adequate and continued essential rail services is being seriously imperiled.

From the public's standpoint, the status quo is intolerable. Thousands of miles of track are operated under slow orders and thousands of pieces of equipment are out of service, all for want of repair. Unless substantial maintenance and rehabilitation programs are launched, the situation will continue to deteriorate and whatever prospect now exists for an economically viable Northeast rail system will be put hopelessly out of reach.

Until this Court rules, these needs must go essentially unsatisfied. So long as the Act is under constitutional doubt, the $150 million provided by Congress for improvement programs will, as a practical matter, be unavailable to maximum and timely advantage. Similarly, the Trustees are unable to assess what allocation they can make of their own cash resources in aid of improved rail service. For example, the court below and the Special Court have found that continued loss operations are, or will be, constitutionally impermissible without a Tucker Act remedy. But these courts disagree on the availability of that relief. At present, the Trustees are confronted with a cash flow inadequate to pay all claims of administration, such as taxes, and to maintain the system above a bare-bones level. Thus far, taxes have been deferred. If the Tucker Act affords the estate the prospect of compensation for interim

erosion, maintenance programs can be set at the highest levels which cash flow permits. But if compensation cannot be assured, prudence would require that payment of all administration claims be resumed. The consequence — a lowering of the level of maintenance — is inevitable even though, from all points of view, unacceptable.

Without the guidance of this Court, day-to-day decisions with critical import for the future can only be made on a basis unsatisfactory to all interests.

SUMMARY OF ARGUMENT

I.

A decision by this Court on the availability of a Court of Claims remedy, both for any deficiency in the ultimate compensation the Penn Central estate will receive and for any erosion beyond constitutional limits, is in no sense premature. Such a decision is essential to avoid grave harm to the public interest in continued rail service. The Special Court's decision has made it clear that only the assurance of an adequate Court of Claims remedy can make the process of the Act fair and equitable to the Penn Central estate. Only this Court can give that assurance. If the Court should find the issue premature, Penn Central would be excluded from reorganization pursuant to the Act. Such exclusion is wholly unnecessary if a Court of Claims remedy is available.

Unless the availability of a Court of Claims remedy is now affirmed, the Act must be held unconstitutional. Once Penn Central is included in the process of the Act, mandatory conveyance of its properties follows inexorably; thus the assurance that compensation will be adequate must now be available if the Act is to be sustained. Similarly with respect to the erosion issue, there is no basis other than the

availability of Court of Claims relief to avoid now holding the Act unconstitutional, since the Act plainly requires continued Penn Central rail operations and all parties admit the possibility that such operations have passed or will pass constitutional limits if for the account of the estate.

II.

The Court plainly has jurisdiction to decide the Court of Claims issue. Such a decision would in no sense be a "declaratory judgment" against the United States, but is rather the only basis for denying the injunctive relief sought by appellees. Such a denial, on the ground that appellees have an adequate remedy at law, is conventional and proper, and poses no doubtful question of jurisdiction.

As to the question of availability of a Court of Claims remedy, the New Haven Trustee admits that the Court of Claims would have jurisdiction but argues that it would be compelled to deny relief for want of a substantive cause of action, on the theory that in enacting the Act Congress did not intend to create such a cause of action. The argument is wholly untenable. Case law in this Court is uniform that, when private property is taken by the Government pursuant to Congressional authorization, the Constitution itself creates a cause of action, and the Tucker Act provides the remedy. Whether Congress intended to exercise the eminent-domain power, or intended to deny or to limit compensation for a taking, is irrelevant. So long as Congress has authorized — as it clearly has here — the acts which in law constitute a taking, both the right to compensation and the remedy therefor are fully available.

III.

The Court below correctly held unconstitutional the provision of Section 207(b) of the Act which requires

dismissal of the Section 77 reorganization proceeding with respect to any Northeastern railroad excluded from the process of the Act. That provision is void as a geographically non-uniform rule of bankruptcy, and probably as a violation of the due-process and equal-protection clauses as well. The provision irrationally denies Northeastern railroads excluded from the Act the substantial advantages of reorganization under Section 77, and relegates them to the quite different fate of an equity receivership. The defective provision is unnecessary to the general structure of the Act and can readily be severed.

ARGUMENT

I.

THE COURT SHOULD NOW DECIDE WHETHER A COURT OF CLAIMS REMEDY IS AVAILABLE TO THE PENN CENTRAL ESTATE.

The Act can and should be found to assure the Penn Central estate of all the rights guaranteed to it by the Fifth Amendment, because — as the Special Court held on September 30 — a suit in the Court of Claims under the Tucker Act is available to remedy any deficiency in compensation which may occur under the process of the Act itself. On the other hand, unless there is a full and unqualified right to recover from the United States in the Court of Claims any amount which is necessary to meet the requirements of the Fifth Amendment, the Act cannot be sustained.

In the interests of both public and private concerns, this paramount issue — whether such a remedy in the Court of Claims is available — must be resolved promptly. If that remedy exists, the Trustees can safely await the resolution of the presently unknown — and indeed unknowable —

questions which inhere in the future implementation of the Act. If the remedy does not exist, the Penn Central estate should be freed immediately from the strictures which the Act imposes.

Unfortunately, the Government appellants sought to have the Court postpone its decision on that issue. However, the recent decision of the Special Court has demolished the Government's prematurity arguments.

Since the earlier briefs were filed, the Special Court has held that absent a Tucker Act remedy the process of the Act is not fair and equitable to the Penn Central estate. That holding is unreviewable under the Act (Section 207(b)). However, the Special Court was concerned whether, if this Court does not reach the Tucker Act issue, its own view that the remedy is available would have the "preclusive effect" necessary to make the remedy adequate (Opinion, pp. 111-16).

Those doubts are well founded. If this Court finds the issue premature, the Special Court will have to conclude that Penn Central must be excluded from the Act. Only a present decision by this Court conclusively establishing Tucker Act availability, both as to compensation and as to interim erosion, will support the Special Court's conclusion that the Act is fair and equitable and will permit the process of the Act to be implemented.

1. **Compensation.** The first aspect of the Act which makes a potential Court of Claims remedy vital to its constitutionality is the manner in which it provides consideration for the rail properties of the Penn Central estate which will have to be conveyed to Conrail. Absent a Court of Claims remedy, the Act does not provide the assurance to which the estate is constitutionally entitled that it will

receive constitutionally adequate payment.[1] The reasons advanced by the majority of the court below for holding this matter premature are inadequate (Trustees' Brief, pp. 48-54). Since USRA (in its "appellee" brief, pp. 17-22) advances different reasons, additional comment is warranted.

USRA recites a variety of matters which are presently unknown — the proper measure of the value of the rail properties of Penn Central which it will be forced to convey to Conrail, what those properties will be, and what consideration will be tendered in return. These are indeed unknown; USRA's extended discussion of the various valuation methods (pp. 56-70) underscores the uncertainties in this area. But it is precisely because they are unknown that the Act, by itself, cannot provide *assurance* that the Penn Central estate will be adequately compensated. What is indisputable is that Penn Central will be

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[1]Trustees' Brief, pp. 54-62. One additional comment on that issue is appropriate.

At page 60 of the Trustees' Brief, it was pointed out that the deficiency judgment against Conrail available as a last resort under Section 303(c)(2)(C) was, as Judge Fullam noted (J.A. 137), "relatively pointless," since it would only decrease whatever value the Conrail common stock might have. USRA now agrees. It says: "It may be that such a judgment would be ineffective in correcting any substantial shortfall in the consideration received by the Penn Central estate, since that estate will probably be the largest single holder of Conrail securities" (appellee brief, p. 28, n. 24). Presumably USRA agrees that the assertion by the United States (p. 45, n. 25) that a judgment would have priority over claims of the Association against Conrail is in error. Under Section 211(e)(3) of the Act the Association can make loans to Conrail only on adequate security; it is doubtful that USRA would accept a subordination to a future possible deficiency judgment. In addition, if the deficiency judgment can prime Conrail's debts, the ability of the new corporation to seek private sector financing in the meantime would be most doubtful.

required to convey very substantial rail properties. *Perhaps* the process of the Act will provide it with constitutionally adequate consideration, but neither the United States nor USRA asserts as a *certainty* that it will. The United States asserts (p. 39) that "the Rail Act *appears* to provide considerable promise of success." (Italics supplied.) USRA says (appellee brief, p. 28) that the remedies available to the Special Court under Section 303(c) "*may* fully correct any deficiencies in the terms of the transfer." (Italics supplied.) Plainly, when property is being taken, the constitutional guarantee of just compensation is not accorded by a possibility, or even a probability, that it will be paid. *Joslin Mfg. Co. v. City of Providence*, 262 U.S. 668, 676 (1923); *Cherokee Nation v. Southern Kansas Ry.*, 135 U.S. 641, 659 (1890); *Stringer v. United States*, 471 F.2d 381 (5th Cir. 1973). The *assurance* of payment requires that a Court of Claims remedy be available if it is needed. And its availability *vel non* is as ripe for decision now as it will ever be.

Indeed, USRA is itself not consistent on this prematurity issue. In its "appellant" brief, it urges that the Court deny injunctive relief on the "taking" issue because a remedy in the Court of Claims is available and adequate (pp. 40-60). Even in its "appellee" brief it several times asserts (pp. 29, 33 n. 29, 48) that a remedy is available in the Court of Claims for any inadequacy in the consideration provided under the process of the Act iself. Whether that is so is precisely the issue which we believe the Court should now address and decide.

2. **Interim erosion.** The second aspect of the Act which makes necessary a possible Court of Claims remedy if the Act is to be sustained is its failure specifically to provide relief for interim erosion. The court below found this issue

ripe for decision and, concluding that no Court of Claims remedy exists, enjoined the operation of several sections of the Act. The Government appellants now urge that the Court need not decide whether a Court of Claims remedy exists. Here again, their arguments are nullified by the Special Court's decision.

For the Court to reach this issue it is not necessary to decide whether, in fact, erosion of the Penn Central estate since June 1970 has reached the point where the estate could not be constitutionally required to bear further operating losses. The court below looked rather to the likelihood that such a point had been reached, or would be reached before the final system plan could be implemented. Its conclusion that the likelihood was great is supported by the opinion of other courts which have been intimately involved in the Penn Central proceedings — the Penn Central Reorganization Court, both in early 1973 (*In re Penn Central Transportation Co.*, 355 F. Supp. 1343, 1344, 1346) and in its 180-day decision under the Act (J.A. pp. 124-51), and the Court of Appeals for the Third Circuit (*In re Penn Central Transportation Co.*, 494 F.2d 270, 283 (1974)). The likelihood which was envisioned by the court below has now been increased by the recent admission [2] that USRA cannot meet the time schedule in the Act, and that a four-month extension of the planning process is necessary.

As the court below found, Penn Central has been suffering huge losses, and loss operations are continuing. The details need not be of concern to the Court. However, because of the remarkable contention of the United States

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[2]Letter, Arthur Lewis, Chairman, USRA, to Hon. Harley Staggers, dated September 4, 1974. A bill to grant the requested extension was favorably reported in the Senate on September 30, 1974. S. Rep. No. 93-1192, p. 70 (Sec. 208(a)).

that the Penn Central estate is really better off now than it was when it filed for reorganization (Brief, pp. 63-65), there is appended a statement of the evidence in the record dealing with the nature and extent of the financial and asset erosion which has already occurred, and which may be anticipated to occur in the future.

Both USRA's appellant brief and that of the other Government appellants asked this Court to decide that a Court of Claims remedy exists, and suggested that other means of saving the constitutionality of the Act should be explored *only if* the Court rejected their Tucker Act argument. However, in its brief as appellee USRA seems to suggest that, even if further loss operations for the account of the estate reach the point of unconstitutionality, a Court of Claims remedy is unnecessary and hence that its availability *vel non* need not be decided. USRA asserts that compensation for any unconstitutional taking can be provided by the Special Court (USRA appellee brief, pp. 27-28). The Trustees have fully responded to that contention in their main brief (pp. 41-42).[3] USRA also asserts that, in any event, the Penn Central estate can avoid an unconstitutional loss operation by terminating its operations. (The Trustees had believed, on the basis of both Government appellants' briefs, that the Government wished the Court to reach that issue only if it first held that no Court of Claims remedy is available.) While this argument is also addressed in the Trustees' brief, further comment is warranted.

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[3]The criticism by USRA ("appellee" brief, p. 28, n. 28) of the legislative history cited in the Trustees' brief at p. 41, note 14, is misplaced. The committee report was not inaccurate, since it was essentially quoting the language of Section 502(d) of H.R. 9142. (In the prior footnote on p. 41 of the Trustees' brief (note 13) Section 304(f) is incorrectly referred to as Section 305(f).)

The briefs for the Government parties appear to argue that if and when the point of unconstitutional erosion is reached — and they do not deny that it may be reached prior to the time the estate is relieved of operating responsibility [4] — USRA will authorize a termination of all Penn Central operations. That any such authority in USRA was within the contemplation of Congress does violence to the entire statutory scheme. It cannot seriously be proposed that this Court rule the Act valid even without a Court of Claims remedy because Congress intended that all Penn Central service could stop when erosion became an unconstitutional burden. The Special Court squarely rejected the Government's argument (Opinion, pp. 45-47), cogently remarking that "this is standing [Section 304(f)] on its head" (p. 46).

Since only a present decision in favor of a Tucker Act remedy, with respect to erosion as well as to ultimate compensation, will suffice to make the process of the Act fair and equitable to Penn Central, acceptance of the Government's argument would almost certainly result in Penn Central's exclusion from the Act. The Special Court has strongly so intimated (Opinion, pp. 111-16). If this Court were to accept the Government's prematurity argument, and the Special Court were to persuade itself — as we think it would not — that its own view as to Tucker Act availability furnished sufficient assurances of fairness and equity, the result would be further delay which could well be fatal to the enormous public interest in continued Penn Central rail operations. A new round of time-consuming

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[4] The USRA appellant brief, in discussing the injunction issued by the court below with regard to Section 304(f), states that the court "deals with a situation which has not arisen and *may not* arise" (p. 71; italics supplied).

litigation would be required as to whether the point of unconstitutionality of operations has been reached. Meanwhile, Penn Central would remain in its present limbo. Improvements essential to stem continued deterioration of the railroad, such as those contemplated by the Act, may not be justified so long as the ultimate solution is wholly in doubt. Penn Central operations are essential to the national economy, and become even more essential with energy shortages, the risk of massive unemployment and other developments. Cessation of service as a result of another round of litigation — the only alternative the Government offers to deciding the Court of Claims issue — is unthinkable. Failure by the Court to decide the issue now is not only legally unwarranted but would have the gravest possible consequences in fact.

The Government also now suggests (U.S. Brief, p. 31) that continuing erosion of the estate can be ignored because the erosion would be even greater if the estate were to be liquidated. There are several answers. Even were the Government's assertion correct in fact, which it is not, it would not warrant depriving the creditors of the estate from exercising their rights. In *Case v. Los Angeles Lumber Co.*, 308 U.S. 106 (1939), the Court was asked to approve a reorganization plan, which was otherwise not fair and equitable, on this ground. Its answer was categorical (p. 123):

> "The fact that bondholders might fare worse as a result of a foreclosure and liquidation than they would by taking a debtor's plan under § 77B can have no relevant bearing on whether a proposed plan is 'fair and equitable' under that section. Submission to coercion is not the application of 'fair and equitable' standards."

But in any event. the Government is wrong on the facts. Its argument assumes (U.S. Brief, p. 73) that liquidation is the only alternative to continued deficit operations. The enactment of the Act now before the Court reveals that assumption to be untrue. Congress has made it clear that the national interest will not permit a cessation of Penn Central services. A determination by this Court that continued erosion beyond constitutional limits cannot, absent a Tucker Act remedy, be constitutionally compelled will not lead to a scrapping of Penn Central. More likely, the public need for rail services and the private rights of property owners will be more appropriately reconciled.

Moreover, on its own premises, the Government assertion is in error. Under the Trustees' plan of July 1973, erosion from the deficit-ridden rail operations of Penn Central would have ended in 1975, and the reorganization proceeding would have been far advanced. The details are set out in the Appendix, *infra*, pp. A-24-26. Under the Act, erosion will continue at least into 1976 — since the Congress will have no choice but to allow USRA the additional time it has requested — and it may continue far beyond that, if Congress disapproves the USRA plan.

II.

APPELLEES' ARGUMENTS AGAINST A COURT OF CLAIMS REMEDY ARE UNFOUNDED.

The New Haven Trustee argues (brief as appellee, pp. 33-37) that the District Court was without jurisdiction to determine whether just compensation can be obtained in an action in the Court of Claims for any taking of property effected by the Act. The New Haven Trustee apparently contends that this Court as well is without jurisdiction to determine that issue. This position is untenable.

The District Court was lawfully convened pursuant to 28 U.S.C. §§ 2282 and 2284 to consider the constitutionality of the Act and the propriety of declaratory and injunctive relief with respect thereto. That it was within the jurisdiction of the District Court to determine the constitutionality of the Act cannot be questioned. See, *e.g., Marbury v. Madison,* 5 U.S. (1 Cranch) 137, 176 (1803); *Amalgamated Meat Cutters and Butcher Workmen v. Connally,* 337 F. Supp. 737, 744 (D.D.C. 1971); *Bartley v. Finch,* 311 F. Supp. 876, 878 (E.D. Ky. 1970), *aff'd,* 404 U.S. 980 (1971). Obviously, neither the District Court nor this Court can perform this process of constitutional adjudication and, at the same time, ignore a substantial argument tending to sustain the constitutionality of the statute at issue. To adopt the New Haven Trustee's truncated process of constitutional adjudication could yield the truly bizarre result that what is in fact a constitutional statute would be held unconstitutional and enjoined from operation because of a less than full consideration of the possible bases for sustaining its constitutionality.

The New Haven Trustee suggests (pp. 33, 35-36) that Penn Central seek a declaratory judgment which even the Court of Claims is without jurisdiction to grant. But, as Judge Learned Hand once observed:

> "[I]t is absurd to speak of a judgment as 'declaratory' in so far as it 'declares' no more than is necessary to sustain the immediate relief prayed, for in that sense every action is for a 'declaratory judgment.' A court cannot grant any relief whatever except as it finds, and by finding 'declares,' that the plaintiff has those rights on which the remedy must be based." *Corcoran v. Royal Development Co.,* 121 F.2d 957, 959 (2d Cir.), *cert. denied,* 314 U.S. 691 (1941).

Federal courts have in fact regularly ruled upon the extent of the jurisdiction of other federal courts — including the jurisdiction of the Court of Claims under the Tucker Act — as necessary to dispose of cases before them. [5] In precisely the same fashion, it is both proper and necessary for this Court now to analyze the effect of the Act upon the jurisdiction of the Court of Claims, thereby avoiding the serious questions which have been raised as to the constitutionality of the Act.

The New Haven Trustee disclaims any suggestion that the jurisdiction of the Court of Claims under the Tucker Act was in any way impaired by the Act; he "has not asserted at any time that the jurisdiction of the Court of Claims under 28 U.S.C. § 1491 was impliedly repealed by the RRRA" (p. 41; see also p. 63 n. 52). The concession is dispositive. The New Haven Trustee does argue that, notwithstanding the fact that the jurisdiction of the Court of Claims is unimpaired by the Act, no substantive cause of action would exist. But that argument is made wholly untenable by the uniform case law in this Court.

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[5] See, *e.g.*, Yearsley v. W.A. Ross Construction Co., 309 U.S. 18 (1940); Hurley v. Kincaid, 285 U.S. 95 (1932); Stringer v. United States, 471 F.2d 381, 383-84 (5th Cir.), *cert. denied*, 412 U.S. 943 (1973); Putnam Mills Corp. v. United States, 432 F.2d 553 (2d Cir. 1970); Myers v. United States, 323 F.2d 580, 583 (9th Cir. 1963); Ove Gustavsson Contracting Co. v. Floete, 278 F.2d 912, 914 (2d Cir.), *cert. denied*, 364 U.S. 894 (1960); Spevak v. Strauss, 257 F.2d 208 (D.C. Cir. 1958), *remanded on other grounds*, 359 U.S. 115 (1959); Ogden River Water Users' Assn. v. Weber Basin Water Conservancy, 238 F. 2d 936, 942 (10th Cir. 1956); Angilly v. United States, 199 F.2d 642 (2d Cir. 1952); State Road Dept. v. United States, 166 F.2d 843 (5th Cir. 1948); Yuhasz v. United States, 109 F.2d 467 (7th Cir. 1940); Parrish v. Seamens, 343 F. Supp. 1087, 1092-94 (D.S.C. 1972), *aff'd*, 485 F.2d 571 (4th Cir. 1973); Nehf v. United States, 278 F. Supp. 444 (N.D. Ill. 1967). *Cf.* Larson v. Domestic & Foreign Commerce Corp., 337 U.S. 682, 697 n. 13, 703 & n. 27 (1949).

The New Haven Trustee claims that an action for just compensation as a result of the taking of property by the United States is available only if "Congress in fact *intended* to authorize the exercise of the sovereign's eminent domain power" (p. 62). (Italics supplied.)[6] But the substantive right to receive just compensation is derived directly from the Fifth Amendment itself and requires nothing more. "If there is a taking, the claim is 'founded upon the Constitution' and within the jurisdiction of the Court of Claims to hear and determine." *United States v. Causby*, 328 U.S. 256, 267 (1946). *Accord, Armstrong v. United States*, 364 U.S. 40, 48-49 (1960); *United States v. Dickinson*, 331 U.S. 745, 748 (1947); *Jacobs v. United States*, 290 U.S. 13 (1933); *Aris Gloves, Inc., v. United States*, 420 F.2d 1386, 1391 (Ct. Cl. 1970); *Eyherabide v. United States*, 345 F.2d 565 (Ct. Cl. 1965). The Special Court so held, noting that the irrelevance of Congressional intent to the existence *vel non* of a substantive claim is demonstrated by "cases too numerous to require citation" (Opinion, p. 85).

It is not necessary that the Government intend to take the property; so long as the acts which in law constitute a

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[6]The New Haven Trustee also contends that Congress could not have intended to allow claimants to the estate of a railroad to litigate their claims first in the Special Court under the provisions of the Act and then, "if not satisfied with its judgment, [to] commence a second round of litigation in the Court of Claims" (p. 42). This argument distorts the situation with respect to the remedies available for any taking effected by the Act. Exercise of the right to recover just compensation in the Court of Claims would not involve duplication of or conflict with the processes for which provision is made in the Act. Matters adjudicated in the Special Court would be governed by doctrines of res judicata and collateral estoppel in a subsequent action for just compensation in the Court of Claims. See. *e.g.*, Edgar v. United States, 145 Ct. Cl. 9 (1959); Smithers v. United States, 150 Ct. Cl. 649 (1960). There is no prospect that it would be necessary in the Court of Claims to retrace the steps of the Special Court.

taking occur, and they were duly authorized, the Fifth Amendment, without more, confers a substantive right to receive just compensation and under the Tucker Act the Court of Claims has jurisdiction to enforce that right.[7] In *Armstrong v. United States*, 364 U.S. 40 (1960), this principle was applied in holding that the possessors of materialmen liens on certain partially completed boats which had been taken by the United States, thereby rendering the liens unenforceable, were entitled to just compensation in the amount of the liens effectively destroyed. This Court said: "Since this acquisition was for a public use, however accomplished, *whether with an intent and purpose of extinguishing the liens or not, the Government's action did destroy them* and in the circumstances of this case did thereby take the property value of those liens within the meaning of the Fifth Amendment. . . . A fair interpretation of [the] constitutional protection [of the Fifth Amendment] entitles these lienholders to just compensation . . . ." 364 U.S. at 48-49. (Italics supplied.) *Accord, Yearsley v. W.A. Ross Construction Co.*, 309 U.S. 18, 21 (1940); *Hurley v. Kincaid*, 285 U.S. 95, 104 (1932); *Portsmouth Harbor Land & Hotel Co. v. United States*, 260

[7]The New Haven Trustee asserts (pp. 38-41) that the decision in Eastport S.S. Corp. v. United States, 372 F.2d 1002 (Ct. Cl. 1967), supports the view that a substantive cause of action for just compensation arises under the Fifth Amendment only where Congress evidences an intent to exercise its eminent-domain power. *Eastport* in fact makes plain that the substantive right to recover just compensation is not dependent upon the intent of Congress. "Under Section 1491 what one must always ask is whether the constitutional clause *or* the legislation which the claimant cites can fairly be interpreted as mandating compensation by the Federal Government for the damages sustained." 372 F.2d at 1009. (Italics supplied.) The Court of Claims obviously spoke in the disjunctive: legislation may, to be sure, mandate the payment of compensation but so, too, do certain provisions of the Constitution. The Fifth Amendment is, of course, the classic instance of a constitutional provision which mandates the payment of compensation.

U.S. 327 (1922); *Sioux Tribe of Indians v. United States*, 315 F.2d 378, 379 (Ct. Cl. 1963); *Richard v. United States*, 282 F.2d 901, 904 (Ct. Cl. 1960); *Cotton Land Co. v. United States*, 75 F. Supp. 232, 235 (Ct. Cl. 1948).

Since the substantive right to recover just compensation under the Fifth Amendment is in no way dependent upon the intent with which Congress or any other governmental authority acts in taking property, it is without relevance here that evidence of a Congressional intent to subject the United States to suit may or may not be found in decisions such as *Hurley v. Kincaid*, 285 U.S. 95 (1932), *Yearsley v. W.A. Ross Construction Co.*, 309 U.S. 18 (1940), and *Silesian-American Corp. v. Clark*, 332 U.S. 469 (1947) — decisions which unequivocally establish that the availability of an action for just compensation under the Fifth Amendment will render lawful action on behalf of the United States which results in the taking of property. Still, it should be observed that, contrary to the New Haven Trustee's assertion (pp. 44-45), these decisions did involve situations in which Congress had not clearly evidenced an intent that the injured party was to be paid. While the attempts of the New Haven Trustee to impose his theory on *Hurley* and *Silesian-American Corp.* are not persuasive,[8] the decision in *Yearsley* is most plainly inconsistent with his theory.

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[8] The New Haven Trustee seeks to reconcile *Hurley* with his theory on the basis that Congress had expressly provided for the exercise of eminent-domain powers in the context of the project which was to result in the taking of the plaintiff's land (pp. 44-46). But in deciding *Hurley* this Court placed no emphasis whatever on the eminent-domain powers provided by Congress; on the contrary, the case was decided by this Court on the assumption that the federal officials were acting in disregard of those powers. See 285 U.S. at 104. It was nothing more than the Fifth Amendment — combined with the waiver of immunity effected by the Tucker Act — that ensured the plaintiff in *Hurley* an adequate remedy at law. (continued)

In *Yearsley*, riparian landowners sought to recover damages from a government contractor for erosion of their lands as a result of work performed by the contractor pursuant to a contract with the United States to improve navigation in the Missouri River. This Court found it unnecessary to determine whether the landowners were entitled to recover compensation from the contractor because, if a taking of their property had occurred as a result of the acts of the Government's agent, "there must be just compensation under the Fifth Amendment" and "the Government . . . has afforded a remedy for its recovery by a suit in the Court of Claims." 309 U.S. at 21. The Court did not find that Congress had intended or even anticipated that

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*(continued)

As for *Silesian-American Corp.*, this Court made no reference to the statutory compensation provision, § 9 (a), upon which the New Haven Trustee relies (pp. 48-53), in upholding the constitutionality of the Trading with the Enemy Act on the ground that under the Constitution just compensation would be available to any friendly aliens whose property was taken under that Act. See 332 U.S. at 477-78. Moreover, while at the time of this Court's decision in *Silesian-American Corp.* it was established that the statutory remedy of § 9(a) was available to a friendly alien whose property had been taken, see Clark v. Uebersee Finanz-Korporation, 332 U.S. 480 (1947), such was not the case at the time of the decision of the Court of Appeals. On the contrary, before the Court of Appeals both parties to the action took "the position that a friendly alien may not sue under § 9(a)." Silesian-American Corp. v. Markham, 156 F.2d 793, 797 (2d Cir. 1946). Acknowledging the substantiality of that position, the Court of Appeals said: "However that may be, it is settled by many decisions of which we need only to cite the last — *Yearsley v. W.A. Ross* . . . — that when the United States seizes the property of an individual, not an enemy, . . . it impliedly promises to pay just compensation, and that that promise is just compensation under the Fifth Amendment." 156 F.2d at 797. Plainly, the Court of Appeals' decision was based exclusively upon the right of just compensation under the Fifth Amendment, and necessarily implicit in the court's reference to that right was reliance upon the jurisdiction created by the Tucker Act which permitted the right to be enforced.

compensable takings of property would occur in the course of the navigation project;[9] rather, it held merely that the navigation project itself had been validly authorized by Congress, thereby making the project the responsibility of the United States.[10]

The New Haven Trustee reviews (pp. 43-63) an array of cases which purportedly support the view that the taking of property by the United States will be enjoined where Congress has failed to evidence its intent to exercise its eminent domain powers and to subject the United States to liability for just compensation. These cases bear no such construction.

First, there is the famous case of *United States v. Lee*, 106 U.S. 196 (1882), in which this Court allowed an action in

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[9]The Act of January 21, 1927, 44 Stat. 1010, 1013, pursuant to which the project was conducted, see 309 U.S. at 20, was wholly silent with respect to any payment of just compensation for any taking of property which might result from the project.

[10]Nor is the New Haven Trustees's theory of Congressional intent of any avail in disposing of Fort Berthold Reservation v. United States, 390 F.2d 686 (Ct. Cl. 1968), where it was held that the taking of certain Indian reservation lands by the United States for inadequate consideration gave rise to a substantive right under the Fifth Amendment to receive just compensation for the property taken. The New Haven Trustee wrongly asserts (pp. 53-54) that the Indians in *Fort Berthold* would have been "without any substantive remedy" for the taking of their property for inadequate compensation but for the passage of the Indian Claims Commission Act. For purposes of the Fifth Amendment claim at issue in *Fort Berthold*, the Indian Claims Commission Act served a single essential function: it effectively removed the six-year statute of limitations which Congress attached to the general waiver of sovereign immunity effected by the Tucker Act. See 28 U.S.C. § 2501. From the date of the taking of their reservation lands in 1910, the Indians in *Fort Berthold* had had a substantive right to just compensation, but the statute of limitations for prosecuting a claim based on that right in the Court of Claims had run in 1916 without the Indians' acting.

ejectment to be maintained against a federal officer who seized property to which it was established the United States did not have title. At the time *Lee* was decided, the Tucker Act had not yet been enacted; thus the sovereign immunity of the United States stood as a bar to any attempt by the plaintiff to recover just compensation under the Fifth Amendment. Only ejectment of the federal officer and restoration of the property to the plaintiff could secure the Fifth Amendment right at stake in *Lee.* Since the Government had made no provision for compensation, the officer's entry was itself unconstitutional. Today, however, the United States is subject to suit for claims for just compensation as a result of the Tucker Act; hence *Lee* provides no authority for the award of equitable relief in this action.

Land v. Dollar, 330 U.S. 731 (1947), is equally unhelpful to the New Haven Trustee. *Land* was brought by corporate stockholders who sought equitable relief to compel the Federal Maritime Commission to return shares of stock which had been delivered to the Commission in return for financial assistance to the corporation. The Commission refused to return the shares on the ground that it possessed full title to them. The District Court dismissed the action, holding it was a suit against the United States. This Court reversed. While recognizing that affirmative relief was not available against the United States, it observed that "public officials may become tort-feasors by exceeding the limits of their authority," thus justifying the issuance of equitable relief against their individual wrongful acts. 330 U.S. at 738. Thus in *Land* the Court was really applying the rule that "[i]n the absence of authority, even an intentional taking cannot support an action for compensation under the Tucker Act," *Mitchell v. United States,* 267 U.S. 341, 345 (1925). Action taken by federal officials in excess of their lawful authority does not constitute action of the United States and cannot, as a consequence, impose any

liability on the United States under the Fifth Amendment.[11] Here, by contrast, there is no dispute that Congress has fully and expressly authorized the acts which in law constitute a taking.

The limits of the decisions in *Lee* and *Land* are fully illuminated in *Larson v. Domestic & Foreign Commerce Corp.*, 337 U.S. 682 (1949). *Larson* was an equitable action brought, in essence, to compel specific performance of a contract under which the Administrator of the War Assets Administration had allegedly sold certain coal to plaintiff, but then had refused to deliver it to plaintiff and proposed to sell it to another. In denying equitable relief, this Court first disposed of the plaintiff's reliance on *Lee*, which was decided at a time when "there clearly was no remedy available by which he could have obtained compensation for the taking of his land." 337 U.S. at 697 n. 17. But a remedy in the Court of Claims was available to the plaintiff in *Larson*. "Where the action against which specific relief is sought is a taking or holding of the plaintiff's property, the availability of a suit for compensation against the sovereign will defeat a contention that the action is unconstitutional as a violation of the Fifth Amendment. Compare *Hurley v. Kincaid*, 285 U.S. 95 (1932)." 337 U.S. at 697 n. 18.

As for *Land*, it was deemed to fall into the class of cases which are outside the general prohibition on specific relief

[11]Similarly, in Hooe v. United States, 218 U.S. 322 (1910), this Court, in holding that the unauthorized use of certain property by the Civil Service Commission did not give rise to a claim for just compensation from the United States under the Fifth Amendment, said: "The taking of private property by an officer of the United States for public use, without being authorized, expressly or by necessary implication, to do so by some act of Congress, is not the act of the Government." 218 U.S. at 336. *Cf. also* Philadelphia Co. v. Stimson, 223 U.S. 605, 622-23 (1912).

against government action because the action taken was "not within the officer's statutory powers." 337 U.S. at 701-02. In *Land*, it was pointed out, the complaint "alleged that the members of the Commission 'acted in excess of their authority as public officers.' "[12] 337 U.S. at 702 n. 26. By contrast, the Administrator in *Larson* was found to be acting "within his authority," which justified the denial of equitable relief since compensation would be available to the plaintiff in the Court of Claims. 337 U.S. at 703 & n. 27.

Larson obviously has dual significance for the present action. In the first place, it constitutes yet another instance in which this Court has refused to afford equitable relief against governmental action in view of the availability of an adequate remedy at law in the Court of Claims under the Tucker Act. Moreover, it makes plain that decisions such as *Land* which have, since the enactment of the Tucker Act, granted equitable relief to prevent the taking of property by federal officials have turned simply upon whether the officials were acting within the scope of their official authority, thereby rendering the United States liable for the effect of their acts. These decisions did not turn on any distinction as to whether Congress did or did not intend to subject the United States to liability for just compensation.[13]

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[12]The *Larson* court expressly rejected (337 U.S. at 699-702) the continuing validity of the decision in Goltra v. Weeks, 271 U.S. 536 (1926), a decision in which the New Haven Trustee apparently purports to find some support for his position (pp. 61-62).

[13]No support for the New Haven Trustee's theory is found in Malone v. Bowdin, 369 U.S. 643 (1962), and Dugan v. Rank, 372 U.S. 609 (1963). Both decisions expressly followed *Larson* and therefore denied the specific relief requested to prevent the taking of property by federal officials upon determining that the officials were not acting beyond the limits of their lawful authority. See 369 U.S. at 647-48 and 372 U.S. at 621-23. Thus, in dismissing the suit in *Malone*, this Court observed:

> "Unlike the situation in the *Lee* case, there has been at all relevant times a tribunal where respondents (contd)

The decision in *Youngstown Sheet & Tube Co. v. Sawyer*, 343 U.S. 579 (1952), is, without question, merely a further example of official action in excess of statutory and constitutional authority, requiring the award of equitable relief to prevent the taking of property for which this Court doubted that the Government could ultimately be held liable in an action for just compensation.

In contradistinction to the theory of the New Haven Trustee, the Penn Central Company (pp. 72-75) argues that the specific remedies provided in the Act evidence a legislative intent to preclude resort to a Tucker Act remedy. Support for this theory is sought in *Johnson v. United States Shipping Board Emergency Fleet Corp.*, 280 U.S. 320 (1930), and *Feres v. United States*, 340 U.S. 135 (1950). In fact neither *Johnson* nor *Feres* supports such a conclusion.

In *Johnson*, this Court's determination that claims within the Suits in Admiralty Act could not be alternatively brought under the jurisdiction created by the Tucker Act was explicitly based on the fact that the Suits in Admiralty Act not only provided for the adjudication of all maritime claims resulting from the operation of merchant vessels by the United States but also provided expressly for the repeal of "the inconsistent provisions of all other Acts." 280 U.S. at 326; see *United States Shipping Board Emergency Fleet Corp. v. Rosenberg Brothers & Co.*, 276 U.S. 202, 212-14 (1928). In view of the comprehensive, express repeal provision plus the fact that the same form of relief was available under the Suits in Admiralty Act as under the

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[1](continued)

could seek just compensation for the taking of their land by the United States. That tribunal is the Court of Claims." 369 U.S. at 647 n. 8.

The availability of just compensation for the property taken was likewise emphasized in *Dugan*. See 372 U.S. at 625-26.

Tucker Act, it is understandable that the Suits in Admiralty Act was deemed to preclude resort to the jurisdiction created by the Tucker Act. Here there is no such provision repealing all inconsistent statutes, much less any identity in the forms of relief available under the Act and under the Tucker Act.

The decision in *Feres* is of even less relevance to the present action. *Feres* held that in enacting the Federal Tort Claims Act Congress had never intended to subject the United States to liability for the death or injury of military personnel as a result of negligence which occurred incident to service. The crux of the rationale underlying the decision was that the Tort Claims Act, by its terms, "recognizes and assimilates into federal law the rules of substantive law of the several states, among which divergencies are notorious," 340 U.S. at 142, while "the relationship of military personnel to the Government has been governed exclusively by federal law." 340 U.S. at 146. This Court simply did "not think that Congress, in drafting [the Tort Claims] Act, created a new cause of action dependent on local law for service-connected injuries or death due to negligence." 340 U.S. at 146. Reference to pre-existing legislation providing compensation for service-connected injuries merely confirmed that the relationship between military personnel and the Government was peculiarly federal in character, 340 U.S. at 144, and was thus outside the express scope of a statute which focused exclusively upon liability under local law. Here, there is no doubt that a cause of action to recover just compensation under the Fifth Amendment for any taking of property effected by the Act is within the express terms of the Tucker Act. The only question is whether the Act repealed the Tucker Act by implication. We believe it did not, for the reasons fully set forth in our first brief (pp. 18-25), the governmental briefs and, most recently, the Special Court's opinion.

III.

THE COURT BELOW CORRECTLY HELD ONE CLAUSE OF SECTION 207(b) UNCONSTITUTIONAL.

The court below correctly rejected appellees' contention that the Act is invalid because it violates the geographical "uniformity" requirement of Article I, Section 8, Clause 4 of the Constitution. *Hanover National Bank v. Moyses,* 186 U.S. 181, 188 (1902). However, the court properly found invalid that portion of Section 207(b) which requires a reorganization court, upon a finding that the process of the Act is not fair and equitable to the estate of the railroad over which it has jurisdiction, to dismiss the Section 77 proceeding. Trustees' Brief, pp. 68-69. The extended argument to the contrary in the brief for the United States (pp. 49-54) warrants a more detailed answer.[14]

Most of the Act can obviously be sustained as an exercise of the powers of Congress under the Commerce Clause. The dismissal requirement of Section 207(b), however, cannot rest on any Commerce Clause exercise. It clearly amends the Bankruptcy Act to deny a particular category of railroad debtors, those in reorganization in the Northeast region, the benefits of that Act if they are not made subject to the mandatory conveyance procedures of the Rail Act. This contingent denial of continuing relief under the bankruptcy law to railroads in reorganization in one part of

[14]USRA did not appeal from this portion of the order below, "[s]ince the court's ruling does not materially affect the administration of the Rail Act." Brief, p. 14. In light of the Special Court's decision, of course, the issue is moot unless this Court holds that the Tucker Act issue is premature or disagrees with the Special Court on that issue. In either of these events, the procedure to be followed after Penn Central is excluded from the process of the Act will again become critical.

the United States is a clear, but impermissible, attempt to exercise the bankruptcy power.

It is significant that the United States advances no reason why this provision was included in the Act, and that USRA, which is charged with the Act's administration, did not appeal this portion of the decision below. The Trustees suggested (Brief, p. 70) that the provisions may have been intended to have an *in terrorem* effect — to dissuade attacks on the "process" of the Act lest the result would be a denial of the benefits of Section 77.[15] It is also possible that the Congress believed that it was not in fact amending Section 77 because it was only commanding what it anticipated the reorganization court would be required to do in any event — to dismiss the proceeding if an income-based reorganization was found to be impossible. That this assumption was erroneous is reflected in *New Haven Inclusion Cases,* 399 U.S. 392 (1970), which dealt with a permissible plan of reorganization under Section 77 which was not based on railroad earnings. The legislative history is silent. But whichever the reason, the provision has no relation whatever to the power of Congress over interstate commerce.

[15]The United States suggests that it makes no real difference whether the railroad continues in Section 77. If this be the case, the dismissal provision is completely devoid of sense. In actuality, by eliminating the Interstate Commerce Commission as the architect of the reorganization plan, an equity receivership would probably facilitate the re-arrangement of Penn Central's non-railroad assets. See Trustees' April 3, 1974 Report on Reorganization Planning, p. 8. However, as to the railroad assets, the presence of the Commission as a key element of the reorganization process was deemed essential to avoid the abuses of equity receivership practice. See, *e.g.*, Continental Bank v. Rock Island Ry., 294 U.S. 648, 672 (1935); Lowenthal, "The Railroad Reorganization Act," 47 Harv. L. Rev. 18 (1933).

The opinion of Judge Fullam suggests (J.A. 65) that this provision of Section 207(b) is probably invalid on other grounds as well. Absent a rational basis for a distinction, which has not even been suggested, it would seem to be a violation of the due-process and equal-protection clauses to deny the benefits of a federal reorganization statute to railroads which happen to be in reorganization in one part of the United States, while leaving it fully available to railroads elsewhere. The provision is plainly invalid as a non-uniform provision of the bankruptcy laws.

Respectfully submitted,

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APPENDIX

EROSION, VALUATION AND CLAIMS

This Appendix responds to the appendix of the governmental appellants (U.S. Brief, pp. 59-73) on the same subjects.

I. THE RECORD DEMONSTRATES THAT SUBSTANTIAL EROSION HAS OCCURRED AND WILL CONTINUE TO OCCUR.

The purpose of calculating erosion is to provide a measure of the extent to which the estates are burdened by being required to continue their deficit rail operations during the reorganization process. Erosion has two major elements. The first element, fiscal or financial erosion, arises from the continuing accrual of postbankruptcy claims which are entitled to priority over and must be paid ahead of prebankruptcy claims. Examples of postbankruptcy claims which contribute to erosion are accrual of unpaid taxes, rents or use-and-occupancy payments for leased rail lines, loans which constitute expenses of administration and increases in net current liabilities. Postbankruptcy claims also arise from the accrual of postbankruptcy interest on secured prebankruptcy claims such as mortgage bond issues and property taxes. The second element of erosion, asset or physical erosion, is the physical deterioration caused by rail operations and the resulting decline in the value of the assets of the estates from which both postbankruptcy and prebankruptcy claims must be satisfied. Such declines usually occur in assets employed in rail operations and result from obsolescence, from inadequate maintenance or replacement of physical properties, and from losses in earning capacity or going-concern value.

The facts used by the parties in advancing different theories of erosion are not themselves in serious dispute. The primary record sources for the data are the following:

1. The annual reports of Penn Central to the ICC for the years 1970, 1971, 1972 (known in those years as the "Form A") (Joint Documentary Submission[1] (J.D.S.) 34, 35, and 36) and for 1973 (redesignated commencing with this year as the Form R-1) (J.D.S. 37). These reports contain the basic income-statement and balance-sheet data.

2. The statement of Clarence E. Jackman (J.D.S. 39), Exhibit 18 in the ICC proceeding (hereinafter "Jackman Statement"), as updated by his affidavit (J.D.S. 18) before the Reorganization Court for the hearing of March 25, 1974 (hereinafter "Jackman Affidavit"). Mr. Jackman's statements contain the best evidence as to the inadequate maintenance being performed on Penn Central's rail plant both before and during the bankruptcy, the continuing decline of the physical condition of the rail plant and the impact which that decline is having on the capability of the rail plant to support adequate service, and show that postbankruptcy maintenance has been inadequate and that the amount of maintenance deferrals has *increased* postbankruptcy. Jackman Statement, pp. 12-16; Jackman Affidavit, pp. 3-5; J.D.S. 48 at Tr. 1087-88. This is the only evidence of record on this point.

3. The income-statement and cash-flow projections contained in the affidavit of Ernest R. Varalli (J.D.S. 19) submitted at the March 25, 1974 hearing before the Reorganization Court. These affidavits forecast income-state-

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[1]By agreement among all parties, ten copies of the Joint Documentary Submission, which supplements the Joint Appendix, have been lodged with the Clerk.

ment and cash-flow results for future years and thus provide data used in estimating future erosion.

4. The statement of John S. Guest (J.D.S. 41), Exhibit 22[2] in the ICC proceeding (hereinafter "Guest Statement"), as updated by his affidavit (J.D.S. 20) to the Reorganization Court for the hearing on March 25, 1974 (hereinafter "Guest Affidavit"). Mr. Guest's Statement and Affidavit set forth the Trustees' definition of erosion and marshal the facts pursuant to that definition to estimate the erosion which has occurred and which will occur in the future.[3]

A. THE EROSION WHICH HAS OCCURRED

1. POSTBANKRUPTCY CLAIMS HAVE GROWN TO $745 MILLION.

As of December 31, 1973, postbankruptcy claims against the estates have been created in the amount of at least $540

[2]The ICC record also contains Exhibits 23 (J.D.S. 42) and 24 (J.D.S. 43), which the Government describes as working papers of Mr. Guest. Actually Exhibit 23 was a memorandum prepared by Mr. Guest for counsel to show what his testimony might cover, while Exhibit 24 was a summary of his possible testimony. Both were prepared by Mr. Guest for purposes of discussion with counsel and thus did not reflect comments from counsel on the definition of erosion (ICC Tr. 1821, 1836-38, 1843-45). It is, therefore, not surprising that the testimony of Mr. Guest presented to the Commission contained a different definition of erosion, reflecting the legal advice provided by counsel. It simply does not follow, however, as the Government suggests, that for Mr. Guest to include in his statement a definition of erosion consistent with the legal advice provided by counsel in any way undermines his credibility or impairs the accuracy of the facts which the remainder of his statement presents.

[3]The Government centers much of its attack on the estimates of erosion in an assault on Mr. Guest's credibility. Not only is the assault

(continued)

million and more likely as much as $745 million. These claims arise from the following sources:

Trustees' Certificates	$ 100 million
State and Local Taxes	241 "
Rentals or Use and Occupancy Payments	up to 101 "
Storm Agnes Loan	15.7 "
Increase in Net Current Liabilities	183.2 "
Increase on Prebankruptcy Secured Debt	up to 104 "
Total	$ 745 million

State and local taxes are estimated at $241 million. J.D.S. 59, Stip. ¶ 12. Some portion of that amount represents taxes which might legally be characterized as prebankruptcy, depending on what the proper cut-off date might be—the lien date, the billing date, or the payment date. Based on lien date, $44 million to $48 million of that amount would be prebankruptcy *(ibid.)*. Nonetheless, the $241 million estimate still would be reasonable since it is exclusive of interest accruing since the deferral of payment. Guest Statement, pp. 6-7. However these taxes are labeled, they constitute claims prior to creditor claims under local lien law, and in a normal operation are paid out of earnings and not through an invasion of capital or assets.

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[3](continued)
not persuasive; it is aimed at the wrong target. In questioning Mr. Guest's credibility the Government does not seek to discredit the facts to which he testified — with those it is in substantial agreement — but rather the definition of erosion on which he relied. But the definition of erosion involves questions of law, and it was never the Trustees' purpose in offering Mr. Guest to have him support the legal validity of their definition with his expertise. The purpose of offering Mr. Guest was to provide the facts to quantify erosion once it had been defined.

Rentals or use-and-occupancy payments for leased lines can reasonably be estimated to contribute up to $101 million in erosion based on the amounts presently being accrued as lease rentals, due and owing but not paid. Guest Affidavit, p. 9. If the leases ultimately are affirmed, then the lease rentals presently being deferred by court order would all become obligations of the Trustees. In the event the leases should be disaffirmed, the obligations of the lessor and lessee cannot presently be estimated. The lessor would have a claim for breach of lease and for reasonable use-and-occupancy payments for its property. The lessee, on the other hand, would probably be compelled for a time to continue operating the lessor's railway for the lessor's account, which may give rise to a claim by the lessee for operating losses. See Section 77(c)(6) of the Bankruptcy Act, 11 U.S.C. § 205(c)(6). What the results of such accounting might be cannot be estimated at the present time. Guest Statement, p. 7. Moreover, a large portion of most leased line rents represents interest due on secured debt obligations of the lessors which would be claims under any analysis. Many issues of lessor bonds are guaranteed by the lessee.

Postbankruptcy interest accruing on prebankruptcy secured debt would be $104 million on the Debtor's mortgage and collateral trust bonds on the assumption that all are fully secured. Guest Affidavit, p. 9. The Government objects to treating any of this accrual as erosion, on the basis that if the debt is not fully secured interest does not accrue, and that if interest does accrue the claimants are not injured. U.S. Brief, p. 65. It is only if major issues of secured debt are not fully secured that inclusion of postbankruptcy interest on all secured debt overstates erosion. The accrual of interest on fully secured claims diminishes the amount of excess security available to pay unsecured claimants or stockholders, thereby eroding their claims.

2. THE VALUE OF THE RAIL ASSETS HAS DECREASED.

The second aspect of erosion—that is, permanent changes in the value of rail assets brought about by continued rail operations—is more difficult to assess. However, the record supports the conclusion that the value of these assets is being impaired.

The book value of the rail plant other than equipment had declined by $68 million by the end of 1972. Guest Statement, p. 8. That decline, of course, gives effect to additions and betterments, retirements and depreciation. While the Government quarrels with the use of book value, it suggests no alternative. U.S. Brief, p. 62.

Book value is not the best measure of the erosion which has occurred in the value of the rail plant, since it understates the actual erosion in the value of the rail plant. Guest Statement, p. 8; ICC Tr. 2037-39. A more direct measurement of the actual decline in the value of the rail plant is contained in Mr. Jackman's testimony,[4] which shows that annual installations of material since bankruptcy have been inadequate to prevent continuing deterioration of the rail plant by at least the following amounts:[5]

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[4]Jackman's Statement to the Commission measured the amount of deferred maintenance which had accrued on the tracks included within the two core systems as of the end of 1972, while the appendices to his Affidavit updated those figures to reflect conditions as of the end of 1973. By comparing the two it is therefore possible to make an estimate of the amount of deferred maintenance accruing annually on Penn Central at present maintenance levels.

[5]These figures are calculated by subtracting the amounts shown on Appendix C to the Jackman Statement from similar amounts shown on Exhibit T-35 to the Jackman Affidavit, and therefore include maintenance deferrals only for the tracks included in the 15,000-mile core system.

Cross ties	520,000
Switch ties	81,000
Ballast	560,000 tons
New rail	140 miles
Repair rail	210 miles
Depreciable property	$11,450,000

Based on current prices[6] the erosion in the value of the entire rail plant has been at least $190 million, and probably considerably more.

Other evidence of record also strongly suggests that the value of the rail plant has declined since bankruptcy. The Jackman evidence as to the continuing deterioration of the rail plant after bankruptcy and its increasing adverse impact on the quality of service Penn Central can offer and therefore on the revenues it can generate clearly shows that the Penn Central rail plant is worth less as an operating rail facility today than it was at the time of the bankruptcy. Jackman Statement, pp. 12-16; see also Guest Statement, pp. 8-10. The same conclusion follows from the standpoint of liquidation value. While the price of scrap has risen, so, too, has the cost of removal. The continuing inadequacy of

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[6]Using unit prices set forth in the Jackman Affidavit, Ex. T-35, the shortfall on the 15,000-mile system would be $40 million annually, or $160 million since bankruptcy. The proposed 15,000-mile system contains 14,072 route miles and 33,234 track miles, while Penn Central is presently maintaining on its entire system 18,817 route miles and 39,338 track miles (Jackman Statement, p. 5). Thus the amount of actual deferred maintenance on the entire Penn Central system is at least 20 percent larger than on the 15,000-mile core system, or approximately $190 million; the actual amount is undoubtedly larger than $190 million, since financial constraints have forced the Trustees to concentrate their maintenance on main lines included in the core systems.

maintenance suggests that less of the rail materials would be satisfactory for re-use and thus more would have to be sold for the lesser scrap value. Enactment of the Regional Rail Reorganization Act of 1973 manifests a strong Government policy to continue Penn Central's essential rail system in the national interest. Consequently, the standards of valuation may have to reflect its intrinsic railroad value, and not its worth as a soon-to-be-dismantled anachronism.[7] In such event, there can be no doubt as to the substantial impairment wrought by the inability to maintain the plant since bankruptcy.

Mr. Guest estimated that Penn Central's equity in its owned freight equipment had increased by $150 million. Guest Statement, pp. 8-10. This he reduced to $100 million on account of a decline in Penn Central's equity in owned passenger equipment. The increase in the value of Penn Central's equity in freight equipment was caused both by the retirement of debt at a rate faster than depreciation accrual and by an increase in the value of the equipment itself brought about by inflation. The estimate treats all of the equipment as being in good repair, an assumption which is not valid in light of the very high percentage of cars in bad order status for heavy repairs, a percentage which has increased since bankruptcy (*ibid.*; see J.D.S. 9). Nor does the estimate contain any discount on account of obsolescence or the mix of equipment in the Penn Central fleet. Guest Statement, p. 9.

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[7]See In re Port Authority Trans-Hudson Corp., 20 N.Y.2d 24, *cert. denied sub nom.* Port Authority Trans-Hudson v. Hudson Rapid Tubes Corp., 390 U.S. 1002 (1968).

The record, therefore, with respect to changes in value of rail assets may be summarized as follows:

Rail property	at least -$ 190 million
Equipment	100 " (including inflation)
Other assets[8]	50 "
Total	-$ 40 million

Putting the growth in postbankruptcy claims together with the decline in rail assets produces the following result:

Increase in postbankruptcy claims	$ 745 million
Decline in rail assets	40 "
Total	$ 785 million

Overall, therefore, the estates have been eroded by at least $785 million by being forced to bear the burden of deficit rail operations since reorganization.

The primary area in which the Government takes issue with this conclusion relates not to any changes in asset values brought about by continued rail operations but to changes in values of assets not used in rail operations caused by wholly extraneous factors. The value of Penn Central's investment in its nonrail assets has changed since bankruptcy, is changing now, and will undoubtedly change again. The value of Penn Central's numerous investments in other enterprises is constantly being altered by changing interest rate and stock market conditions. Penn Central's Park Avenue properties are primarily fixed rental leases,

[8]Mr. Guest testified to an increase in other assets, primarily escrow funds, which should be included in this analysis. Guest Statement, pp. 5, 16-17.

the value of which declines as interest rates rise. Penn Central's other nonrail real estate has not shared fully in the general inflationary increases in value. Guest Statement, pp. 10-12.

Exhibits 1 and 2 of the Palmieri Report (J.D.S. 44) show the uneven extent to which the various owning companies and first mortgages share in the ownership of the estate's nonoperating properties. In some cases these amounts represent a substantial portion of the company's assets or of the claims secured by the mortgage, but in others they are a very small part indeed. So, too, with the alleged increase in value of the Pennsylvania Company, the stock of which is pledged[9] to a group of banks to secure a lien of $300 million on a revolving credit agreement. According to the Government the value of the Debtor's investment in Pennsylvania Company has increased from $150 million at the time of bankrupty to $203 to $250 million at the present time. U.S. Brief, p. 69. Assuming the validity of the pledge, the sole effect of any such increase would be to satisfy a larger portion of a claim which on these facts is not fully secured. Even if the value of Pennco were to increase by another $100 million, no other creditor group would benefit from that increase, since as soon as the value of the stock exceeded $300 million, the claim would commence accruing postbankruptcy interest which, as of the end of 1973, amounted to $74 million.

Much of the Government's Appendix is directed to an elaborate criticism of the income-statement method of computing erosion, a method which the Government erroneously asserts was employed by the Trustees. U.S. Brief,

[9]The validity of the pledge is the subject of litigation pending in the Reorganization Court.

p. 63. The Trustees agree that income deficits are not the best measure of erosion. They did not use this method in computing their estimate of erosion, but calculated erosion from the growth in postbankruptcy claims together with any change in value of rail assets. However, analysis of income deficits is an alternative means of calculating erosion and one which, in the context of the Penn Central proceeding, produces a very similar estimate of the amount of erosion which has accrued.

The existence of substantial deficits is not disputed; the parties have stipulated that Penn Central's ordinary net losses approximate $851 million for the period from June 21, 1970 through December 31, 1973. J.D.S. 59, Stip. ¶ 10. Moreover, rail operations have continued to produce heavy losses in 1972, and it is conceded by all that such losses will continue in the future.

The Government, however, suggests that five adjustments should be made to the income statements. U.S. Brief, pp. 63-65. These five items, which total $1,027 million, represent, the Government suggests, the amount by which the use of income losses potentially overstates erosion. Since the amount of the adjustments proposed exceeds the income losses by $176 million, the Government's analysis comes close to suggesting the conclusion that the estates have benefited from being forced to assume the rail losses, a conclusion so wholly at odds with common sense as plainly to demonstrate that something is fundamentally wrong with the Government's analysis.

The Government first proposes to eliminate income-statement depreciation from the income losses, asserting that depreciation represents an arbitrary charge which does not reflect actual changes in value, and from this inferring that necessarily the changes in value were far less than the

amount of depreciation taken.[10] The only evidence in the record, however, is that income-statement depreciation understates the actual decline in the values of the properties, particularly of the road properties. ICC Tr. 2037-39. Depreciation is a noncash item, a large portion of which is represented by depreciation on owned equipment. Not included in the income statement (but relied on by the Government to show an increase in the value of the Debtor's rail assets) is the retirement of debt on owned equipment accomplished by the Debtor out of cash flow. The Government overlooks the fact that such retirements, in the absence of earnings, are of no net benefit to secured claimants.[11]

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[10]Similar efforts to conjure away depreciation have been rejected. "Depreciation, however, does not create additions to assets or accessions to assets already held, but is a reflection of the very real economic fact that the assets are being consumed or wasted away in the process of keeping the railroad running and is actually a measure of the contribution of physical properties made by the mortgagees for this purpose." In re New York, N.H. & H. R.R., 278 F. Supp. 592, 604 (D. Conn. 1967), *aff'd.* 405 F.2d 50 (2d Cir. 1968).

[11]The basis for this is spelled out in an opinion by Judge Anderson in In re New York, N.H. & H. R.R., 278 F. Supp. 592, 604 n. 21:

> "For example assume an acquisition of $3,000,000 in equipment under either equipment trust of conditional sale. The equipment obligation is for 15 years, providing for interest at 4.87%, payable semi-annually. It is assumed that the equipment has a useful life of 20 years, at the end of which there will be a 2% net salvage value.
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> "In each year, the principal of the obligation will be reduced by $200,000; annual depreciation charges will be $147,000 and annual interest payments will average $84,282. The balance sheet accounting entries will be as follows: Upon acquisition, an asset of

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The second adjustment proposed by the Government is to eliminate the costs charged in the income statement for track replacement. The Government contends that these replacements enhance the value of the estate and therefore cannot properly be regarded as erosion. Since track is not

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$3,000,000 is added, and a liability in equal amount is also created. As payments are made on principal, the balance sheet liability is reduced by $200,000 annually. Correspondingly, cash is also reduced by $200,000, plus the amount of interest paid. Each year the net book value of the asset is reduced by $147,000, reflecting the depreciation. On the income account, annual depreciation of $147,000 is taken as a charge against revenues. The interest payment is reflected as a fixed charge; it is deducted only *after* arriving at the figure designated 'Income Available for Fixed Charges.'

"At the end of 15 years, principal payments will total $3,000,000, and interest payments will aggregate $1,264,234. The total cash outlay will thus be $4,264,234. At the end of 15 years, the equipment will be carried on the balance sheet as $795,000 with nothing owed thereon. Depreciation charges would have aggregated $2,205,000.

"Under normal circumstances, the owner's equity would have benefited by $795,000, the difference between the amount of the principal payments and the depreciation (reflecting the decrease in value with use) over 15 years. However, cash outlays for interest of $1,264,234 were required to reach this result. Normally, since there is income available for fixed charges, the owner of the enterprise does not suffer an impairment of his equity.

"On the other hand, if there is a deficit in income available for fixed charges, the cash which must be

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depreciable property, however, track replacement can enhance the value of the plant only if replacements exceed the amount of track which wears out. Mr. Jackman's testimony, the only evidence in the record on this point, shows conclusively that track replacements were not adequate to prevent continued deterioration of the rail plant and that the rail plant has continued to deteriorate since bankruptcy at an accelerating rate. Thus, despite the fact that $358 million has been spent on track replacement, the rail plant has less value now than it did prior to bankruptcy. Moreover, in singling out track replacement, the Government is trying to isolate but a single element of the balance sheet. While spending available cash for track replacement may well tend to lessen the erosion in the rail plant, given the cash stringency under which the estates have operated, devoting the cash to track replacement has prevented its being used elsewhere, a fact reflected in other areas of the balance sheet such as the growth of net current liabilities since bankruptcy.

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paid as interest impairs the owner's equity. A deficit in this account means that after other expenses and charges for depreciation, revenues are insufficient to meet interest payments. In the above illustration cash of $4,264,234 was required to discharge the obligation. A non-cash charge to income was depreciation in the amount of $2,205,000. Accordingly, if there is a deficit in income available for fixed charges throughout the 15-year period, corpus will be impaired by the difference between $4,264,234 and $2,205,000, or $2,059, 234. Assuming that the asset is worth its net book value of $795,000 after 15 years, the owner has suffered a net loss in equity of $1,264,234."

The next two adjustments the Government proposes are that deferred leased line rentals and postbankruptcy interest on secured debt should not be treated as erosion because they cannot be quantified with absolute assurance. The comments we have previously made on these two items, see p. A-5, *supra*, apply here as well.

Finally, the Government suggests that the income-statement deficit may overstate erosion to the extent that it includes accrual of interest on unsecured prebankruptcy debt. We agree, except we note that the Government includes in such debt the Pennco debt, which may be secured.

Thus the only adjustment proposed by the Government which should be made to the income statement is to eliminate the $72.5 million in interest accrued on concededly unsecured prebankruptcy debt.[12] Making this adjustment to the income deficit of $851 million produces an estimate of erosion of $778.5 million—an estimate very close to the $785 million in erosion calculated by the Trustees pursuant to their method.

Coupled with its attacks on income-statement erosion is an argument by the Government that the estates have not been hurt by being subordinated to the lien of the Trustees' Certificates or by being forced to use cash generated by their nonrail assets to support rail operations. U.S. Brief, pp. 66-67. The estates have since bankruptcy used $310 million in nonrail income and nonrecurring cash infusions because the rail operations have produced not only net losses but also substantially negative cash flows. The Government suggests that these expenditures have not reduced

[12]Consisting of $35.2 million in interest on short-term notes in default and $37.3 million in interest on miscellaneous obligations other than the Pennco notes.

the value of the estates since additions and betterments and reductions in debt on owned equipment exceed that amount.[13] This suggestion is, at the least, misleading. Normally, additions and betterments and retirements of debt are expected to be covered by revenues, with funds made available by the noncash charge to depreciation. It is because of the inadequacy of revenues and of depreciation to generate these funds that sources external to the rail operation had to be tapped for operations to be sustained. Moreover, "additions and betterments" is a misleading term, since it suggests that the total expenditure represents an improvement, which is not the case here, since much of its limited capital has been spent on safety projects which are necessary to permit the railroad to operate but which do not generally represent an improvement in the sense of adding value or generating efficiency.

A more fundamental objection to the Government's suggestion that the estates have not been harmed by use of external cash sources and income from nonrail operations to sustain rail operations is that, once again, it represents a plain instance of unfairness among creditors. The Trustees' Certificates represent a lien on all of the estate's assets; but the additions and betterments which the Government suggests were funded by the proceeds benefit, if they provide any benefit at all, only those claimants on whose properties they were made. Similarly, the Storm Agnes loan was used to restore the condition of the plant to what existed before a natural disaster occurred. At most, it served to prevent those claimants whose properties were damaged from having their security weakened. But it also created new claims

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[13]The Government does not claim these funds were actually spent for these purposes. The Trustees' estimated erosion includes the effect of these expenditures on both assets and claims.

prior to the interest of prebankruptcy unsecured claimants and stockholders. So, too, with the use of income from nonrail properties to sustain rail operations. That income could have been sequestered for the benefit of the claimants owning the properties generating the income. Instead, it was expended in rail operations or, even accepting the Government's view, for making additions and betterments on properties other than those properties which produced the income. Even in the fortuitous circumstance where cash generated from the income of a property subject to a given lien was expended on additions and betterments subject to the same lien, still it is plain that the estates have been injured. Assuming that the rail system continues to operate, those improvements become worth less with each passing day as they wear out and depreciate. If the railroad is to be liquidated, then surely cash in hand is worth far more than a rail improvement anchored to the ground requiring removal before it can be converted to cash by being sold for re-use or scrap. If the nonrecurring cash infusions and the nonrail income had not been used for rail operations, those amounts would have had to be borrowed for rail operations to continue, thereby creating a postbankruptcy claim ranking ahead of all prebankruptcy claims.

B. FUTURE EROSION

Projecting future erosion is a more difficult task than measuring past erosion, because the same tools are not available. The growth in claims and the changes in asset values must be projected, which in turn requires a projection of the financial results of performing the rail operations. Thus the basic ingredients in an estimate of future erosion are a projection of income or loss, a projection of growth of claims, and a projection of change in asset values.

The Trustees' estimate of future erosion commencing with January 1974 is set forth in the Affidavit of Mr. Guest submitted at the March 25, 1974 hearing. Guest Affidavit, pp. 9-10. That estimate shows that for the years 1974 through 1978 there will be a further growth in postbankruptcy claims of $588 million offset by an increase in Penn Central's equity in owned freight equipment represented by the reduction of equipment debt of $200 million, for a net increase in claims of $388 million. This estimate does not include any estimate for the increase in net current liabilities from the end of 1973 to 1978. Nor does the estimate give any effect to the possible further lowering of the value of the rail plant brought about by continuing maintenance at the present inadequate level, thereby resulting in further maintenance deferrals.

Much of the Government's attack on this estimate of erosion is based on its mistaken belief that Mr. Guest had used the so-called income-statement method. U.S. Brief, p. 63. But, as a reading of Mr. Guest's Affidavit makes clear, that simply is not the case. The only estimate of future erosion made in the affidavit is contained in paragraphs 12 and 13, and those paragraphs plainly deal with the accumulation of administration claims and changes in the value of rail plant and equipment. Mr. Guest does point to the projections of substantial future income deficits as supporting his conclusion that erosion will occur. Indeed, the likelihood that continued substantial net deficits will lead to further erosion seems self-evident.

The suggestion of the Government, see U.S. Brief, pp. 31-32, 72-73, that future erosion will be substantially abated by the availability of funds under Sections 213 and 215 of the RRRA and the recent ten percent freight rate increase is incorrect, since funds from these sources may not be available or adequate to reduce the primary sources of

erosion—namely, the continuing accrual of unpaid taxes, leased line rentals and postbankruptcy interest on secured claims.

Funds under Section 213 are limited to a total of $85 million, not all of which has been appropriated, and are restricted in use. The Government has taken the position that such funds may not be used for the purpose of combating erosion but only to supply the cash necessary to meet payrolls or other expenses, the current payment of which is essential to continued operation. Annex A to Trustees' Brief.

There are similar problems with the loans provided for in Section 215. Those loans may only be used for the purpose of rehabilitating or purchasing needed additions to plant or equipment. Apart from the considerable practical impediment to the immediate availability of such loans arising from the requirement that § 215 loans be spent only on properties that will be included in the final system plan, the loans may not be used directly to reduce any elements of erosion, such as, for example, the current payment of taxes. Moreover, both the Act itself and the public statements of USRA indicate that the loans will not enhance the value of the creditors' security since the amount of the improvement made will be deducted from the consideration paid by Conrail for the assets to avoid any double payment. Thus, loans under Section 215 cannot be used to abate financial erosion and will not cure physical erosion because any gains in value attributable to those expenditures are retained by the Government and do not pass to the creditors.

Finally, the Government suggests that the recent ten percent freight rate increase will reduce the projected erosion. The ten percent freight rate increase was not included in the income projection submitted to the Reorganization Court at the hearing on March 25, 1974. However, Mr.

Varalli subsequently testified to the impact of that increase on his projection during the hearing before the Reorganization Court on June 10, 1974. That testimony shows his earlier projections did not include an inflation rate as high as that being experienced now and likely to be experienced in the future, with the result that the net cash benefit of the increase will be far less than the amount of additional revenues. Moreover, Mr. Varalli's projections assumed that additional rate increases would be granted adequate to offset without lag any wage increases, an assumption which Mr. Varalli conceded was not realistic.[14]

Nor is it fair to assume that the impact of inflation can be wholly avoided through freight rate increases. As is shown in the statement of Mr. Charles C. Shannon, Exhibit 19 in the Interstate Commerce Commission proceedings, neither the freight rate increases requested nor the rate increases granted have been adequate in the past to recover the full amount of inflationary cost increases. Moreover, the freight rate increases which it is now apparent would be required to offset current inflation greatly exceed the increases assumed by Temple, Barker & Sloane in making its forecast of future traffic, thus calling into question the conclusion of that study that the rate increases assumed will not lead to diversion of traffic.

The critical assumption of all of these forecasts of future erosion is that the freight traffic projected will in fact be achieved by the Penn Central. Attaining this goal, however, requires that the continuing deterioration of Penn Central's

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[14]Subsequent testimony in the Reorganization Court at a hearing on Sept. 19, 1974, shows that each one percent increase in wage levels and materials prices not offset by rate increases will add $15 million annually to Penn Central's cash drain. The unions involved are seeking wage increases totaling 35% over the next two years.

plant and equipment promptly be halted, a task which will consume all of the additional funds which the Government has suggested can be used to reduce erosion, including any net cash accruing from the 10 percent rate increase. Moreover, wholly apart from the question of the quality of service Penn Central can provide in light of its plant condition, substantial doubt is cast on the traffic forecasts by the enormous rate increases required to offset all of the unanticipated inflationary cost increases now being realized. Without such offset the forecasts understate future deficits. With such offset it is doubtful that the traffic results can be achieved given the diversion of traffic to other modes resulting from rate increases far above the level assumed in constructing the forecasts.

For all of these reasons, the estimate of future erosion presented to the Penn Central Reorganization Court on March 25, 1974, remains reasonable. That estimate, it should be noted, was based on a projection of income and of cash flow which was inadequate to permit the current payment of state and local taxes, of leased line rentals, or of postbankruptcy interest on mortgage debt. The sources of additional funds which the Government claims may lessen future erosion either cannot be used for that purpose or will be inadequate in amount to significantly lessen the projection. Moreover, $50 million in Trustees' Certificates become due in January, 1976, and would have to be refunded, presumably through another Government guarantee and probably at higher interest costs. And some external source of funds must be found to make up the $60 million cash-flow deficit forecast by Mr. Varalli for 1975 and 1976.

II. THE RECORD DOES NOT SHOW THAT THE VALUE OF THE ESTATES IS ADEQUATE TO PAY ALL CLAIMS.

While there is substantial valuation evidence in the record, it is not adequate to permit a definitive valuation to be made of the assets of the estates. In part, this is because the available studies are dated or were performed for specialized purposes. For example, the Day & Zimmerman liquidation study (J.D.S. 40) has a valuation date of December 31, 1970, and therefore does not reflect any of the changes which have occurred since that date. Similarly, the valuation of Pennco was a valuation made of only some of its assets and then on the assumption of a sale of those assets to third parties at a point in time long since past. Moreover, there are substantial disagreements between the parties as to appropriate valuation standards, and even within a given valuation standard there are disputes as to how particular kinds of assets should be valued.

Similar comments can be made concerning the estimates with respect to claims. Major claims categories have not yet been brought into the proofs-of-claim program for tabulation, verification, and, ultimately, liquidation. Thus, for example, late claims and claims reflecting potential liabilities not immediately recognized by the Trustees are just now being processed; and until the Trustees have affirmed or disaffirmed the Debtor's executory contracts, the proofs-of-claim program cannot include estimates of the very substantial potential claims arising from those leases which are

disaffirmed. For these and other reasons, the claims estimate used by the Government is surely too low.[15]

Not only is the record not adequate to permit a finding as to the total value of all assets and the total amount of all claims, but, more critically, the record is practically devoid of evidence showing the value of individual assets or of the amount of claims which may be charged against individual assets or individual debtors. Even were the total pool of assets adequate to cover the total amount of claims, that does not mean that every claim will be fully recognized and compensated. There are undoubtedly secured claims which are not fully secured and thus not only have lost their right to postbankruptcy interest but have already suffered erosion of their principal. And while in gross the amount of assets might seem adequate to permit recognition of stockholder interests, the Penn Central reorganization does not involve one debtor but rather sixteen, and it most certainly cannot

[15] The Government purports to base its figures on the Trustees' Report on Proofs of Claim. Attachment No. 5 to the Trustees' Plan for Reorganization of April 1. 1972. However, the $1,583 million figure for all prebankruptcy claims used by the Government does not include any portion of the New Haven Trustee's claim other than the portion represented by the Divisional Mortgage. The estimate in the Report of unsecured claims, as the Report states, is an April 1, 1972 figure only, and, moreover, is based on amounts reflected in the Debtor's books. The sum actually claimed as of April 1, 1972 was considerably higher — $3,349 million; so presumably the ultimate liability as of April 1, 1972, as to just the claims discussed in the Report will lie somewhere between $1,583 and $3,349 million. The April 1, 1972, Report does not purport to deal with claims corresponding to the several categories of claimants exempted as of April 1, 1972, from the requirement of filing proofs of claim. Also, the Report does not include any estimate of claims which may be filed by or against leased lines or on account of guarantees.

be said that the assets of each debtor are more than sufficient to cover the claims against each debtor even though the totals may suggest that conclusion.[16]

III. CONTINUED EROSION OF THE ESTATES IS NOT A BETTER ALTERNATIVE TO OTHER SOLUTIONS.

Contrary to the contentions of the United States (Brief, pp. 31, 73), Penn Central would be better off if it were to embark upon a course of action such as that proposed by the Trustees in their Plan of Reorganization filed in July 1973 than if it is forced to continue assuming the burden of rail losses through 1975.

The United States rests its argument on the cash forecast prepared for the Trustees' Plan and submitted to the ICC as Exhibit 7 to Mr. Varalli's Statement (ICC Exhibit 16). That forecast was prepared to demonstrate the ability of the estates to carry out the Trustees' Plan under the least favorable assumptions. The forecast assumed that no payments on account of real estate taxes, leased line

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[16]The uncertainty of claims and values in the case of the principal debtor — Penn Central Transportation Company — is particularly acute. Assuming a reorganization based on sale or other disposition of rail lines with most leases disaffirmed, an important element of value would be PCTC's interests in the leased lines, an interest which on this hypothesis would be represented by its ownership of their stock. Similarly, disaffirmance would create claims by PCTC against the lessors and by the lessors against PCTC, none of which can presently be quantified. All of these matters would have to be resolved in each of the 16 reorganizations before a reasonable appraisal for the prospects of value in PCTC's equity could be made. For the Government to assert in the face of such complexities that all shareholder interests will participate in the reorganizations is the most far-fetched sort of speculation.

rentals, postbankruptcy interest or the Debtor's equipment obligations would be made. The forecast also assumed, however, no income from the sale or disposition of real property, railroad equipment, or rail assets. These assumptions plainly do not reflect the conditions which would actually prevail if the Trustees' Plan were implemented. In 1971 and 1972 the Trustees sold properties for amounts totaling $80 million (J.D.S. 44, p. 11). Under the program set forth in the Palmieri Report (J.D.S. 44), such sales will substantially increase, as will income from nonrail properties. Moreover, given the acute shortage of railroad equipment and the substantial equity of Penn Central in such equipment, it is most unlikely that the Trustees would simply cease paying all equipment obligations and thereby permit the equipment to be repossessed. Instead, the equipment could be sold or rented, on a short- or long-term basis, to other railroads, thereby generating additional cash for the Trustees. Even if the equipment were repossessed and sold, it does not follow that all of the Debtor's equity would be lost or that the estates would not realize cash.

Thus the cash forecast submitted to the ICC substantially understates the cash receipts the estates would enjoy. With proceeds from the sale of real property and with income from the disposition or rental of equipment, the estates would have a greater cash flow, some of which could be applied to the current payment of state and local taxes and to the reduction of other high-priority administration claims. And, as real property was sold, the tax liens against such property would be satisfied and no further taxes would accrue. Consequently, contrary to what the United States suggests, if the Trustees could implement their plan of July 1973 it is likely that the estates could commence paying currently at least some of

the claims which would necessarily continue to accrue as erosion if continued rail operations are required.

More fundamental than the factual shortcomings of the Government's contention is its mischaracterization of the claims which would accrue as erosion at all. Under the Plan which the Trustees proposed to the Commission, the process leading to the final reorganization of the estates would be set in motion. Thus the costs which the Government characterizes as further erosion are not erosion but simply the expenses the estates will incur as part of disposing of their assets and effectuating major steps of the Plan of Reorganization. The key factor is that by the end of 1975, under the Trustees' Plan, all erosion from the continuation of the deficit-ridden rail function would have ended and the reorganization process would have been far advanced. On the other hand, if rail operations must be continued, then by the end of 1975 additional erosion would accrue and the estates might not be any closer to final reorganization than they are today. The Act does not put any time limit on erosion; it would permit the Congress indefinitely to reject successive proposed final system plans. (Moreover, under the Government's theory — a theory we think wholly wrong — the Special Court would be free to refuse to order conveyance pursuant to a final system plan if it found the plan unfair and inequitable. If that happened, early 1976 would find the estates burdened with additional accumulations of erosion and faced with the necessity then for adopting a Plan looking toward disposition of their rail and other assets.)

CERTIFICATE OF SERVICE

I hereby certify that I have this 10th day of October, 1974, caused three (3) copies of the foregoing Brief to be mailed first-class, postage prepaid to:

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